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INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE
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UNCLAS SECTION 01 OF 02 VIENNA 001550

SIPDIS

E.O. 12958: N/A
TAGS: [ENRG](#) [ECON](#) [PGOV](#) [PREL](#) [AU](#)
SUBJECT: Weak Competition Fuels High Energy Prices In
Austria

REF: VIENNA 969 AND PREVIOUS; 04 VIENNA 2972 AND
PREVIOUS

¶1. SUMMARY: Energy prices in Austria Q as in most EU countries Q have soared even more than food prices. As of August 31, energy prices for households were up 14% year-on-year and gasoline cost 15% more (diesel almost 30% more) while the overall inflation rate in this period was 3.7%. Natural gas providers announced a November price hike of 20%. While the lion's share of price increases are due to international energy markets, a significant factor is lack of competition in the electricity, gas, and vehicle fuel markets. END SUMMARY.

SCANT COMPETITION IN ELECTRICITY DESPITE LIBERALIZATION

¶2. In opening its electricity market in 2001, Austria was among the forerunners in Europe. Electricity prices were far above the EU average prior to liberalization. Whereas the market was essentially closed, now foreign companies may freely sell electricity to consumers. After regulators cut network tariffs (which make up about 45% of the final price), prices dropped below the EU average, but have been above the EU average in the past 18 months. Prices for industry and households remained fairly stable between 2003 and mid-2006, but then surged by almost 20% in ¶2007. NOTE: Most of Austria's electricity comes from hydropower and is therefore insulated from fossil fuel developments.

¶3. Despite liberalization, foreign competitors show little interest in selling electricity in Austria and hold only small stakes in Austrian regional providers. Dietmar Preinstorfer, foreign relations officer of the energy regulator E-Control told us market returns in Austria (after network tariffs and taxes) are not attractive enough for foreign companies. There are sufficient domestic electricity providers to be competitive, but they show limited interest in attracting customers with low prices -- investing instead in marketing and image campaigns to defend their regional strongholds. In practice, consumers have little insight into pricing and competitive options so that only 6.6% of customers have changed their provider since 2001.

¶4. Legal unbundling between providers and suppliers, as required in the 2004 EU electricity single market directive, is not happening sufficiently according to E-Control. On the contrary: suppliers are banding together. Austria's biggest electricity provider "Verbund" holds stakes of up to 35% in smaller regional providers, who in return have interests up to 12% in Verbund (and to a similar extent among each other). The

GOA has an implicit interest in protecting pre-2001 incumbents, since those providers must still have 51% ownership by federal or local governments.

GAS: 2/3 OF PRICE HIKE DUE TO LACK OF COMPETITION

¶5. The situation is even worse among natural gas providers, where the market was liberalized in 2002, also well ahead of other EU countries. Austria's oil and gas giant OMV is practically the sole producer and importer of gas (around 90% of consumption is imported). Virtually the same regional providers who sell electricity also supply customers with gas. The only foreign provider is Gazprom: the 2006 gas supply deal with OMV (which guaranteed Russian gas imports to Austria until 2027) allows Gazprom to market gas directly in three of the nine Austrian states.

¶6. Overall, gas prices remained stable between 2003 and 2007 but have risen since 2007. As in electricity, gas prices rose slowly at first because E-Control reduced network tariffs (which account for 50% of the price along with taxes). Two thirds of the current gas price increase can be blamed on lack of competition between the gas providers, according to an Austrian Federal Competition Authority (FCA) study on last summer's price developments.

GAS HUB TRADERS COULD ENTER THE PLAYING FIELD

¶7. In July, E-Control announced a "Competition

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Initiative Gas" to give customers better information on prices and on how to switch provider (only 4% have changed so far since liberalization), and to give gas providers access to pro-competitive instruments such as storage. Bulk gas traders who purchase significant amounts of gas via the Central European Gas Hub trading platform and the associated physical hub in Baumgarten could theoretically enter the Austrian gas market and undercut incumbents.

ARE SERVICE STATIONS CHEATING CUSTOMERS?

¶8. Vehicle fuel retailing appears to be another area of weak competition. FCA experts claim in another study that the four dominant retailers in Austria (OMV, BP, Shell, and Jet/Conoco Phillips) contribute to rising price by asymmetrically passing on to customers crude oil price changes at the reference oil market in Rotterdam. FCA analyzed 1,200 gasoline stations in Austria (60% of the market). On average, wholesale price increases are passed to consumers after 1-2 days whereas price decreases are implemented after 3-4 days. Gasoline retailers denied these allegations, but at the end of September they agreed to cooperate with the FCA and provided confidential price data. FCA is now analyzing that data.

¶9. COMMENT: The energy price situation in Austria shows that global fossil fuel scarcity could be ameliorated by more competition in domestic markets. Despite a headstart on liberalization, Austria's energy sectors are stuck in a state of semi-competition where incumbents can deter entry and "smooth" price developments, often to the detriment of consumers. Faced with a small market historically prone to oligopoly, Austria's energy regulators must become more aggressive. While politicians advocate lower prices, GOA interests are mixed given large-scale public ownership in OMV and other incumbent providers. END COMMENT.

